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S E C R E T SECTION 01 OF 03 RPO DUBAI 000168

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SUBJECT: AHMADINEJAD'S WINGS GET CLIPPED ON ECONOMIC POLICY

REF: RPO DUBAI 000121

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CLASSIFIED BY: Ramin Asgard, Director, Iran Regional Presence Office, DOS.

REASON: 1.4 (b), (d)

¶1. (S/NF) Summary: Iran's Majles dealt President Ahmadinejad a series of setbacks on economic policy in March that signal the forging of a broad-based opposition to the President's populist economic policies. These defeats have hurt, but probably not crippled, his plans to distribute cash and economic benefits to voters before the election in June, but they magnify his lack of accomplishments on the economy, a key issue in the election. The reform of Iran's massive subsidies, and the inefficiencies they encourage, will remain part of the public debate as shown by the Supreme Leader branding the new Iranian year as the "year of reforming consumption." End Summary.

¶2. (S/NF) On March 12 Iran's Majles approved the budget for the new Iranian fiscal year (1388) that began on March 21, following a lively debate that saw the centerpiece of President Ahmadinejad's economic program, subsidy reforms, defeated in a preliminary vote. However, a more significant defeat for Ahmadinejad, according to an Iranian contact who is an Ivy-League educated economics professor at the American University of Sharjah in the UAE (please protect), was the Majles' creation of separate entries in the budget for each of the development projects that Ahmadinejad has awarded during his visits to Iran's provinces. By creating separate budget line items, instead of aggregating the projects in a single fund that Ahmadinejad could disburse at his discretion, the Majles now has more ability to oversee the funding for these projects. This change created thousands of new line items and was the basis for the President's claim that the Majles' numerous amendments had exceeded its constitutional authority. The Guardians Council rejected this claim when it approved the Majles' version of the budget one week later.

¶3. (S/NF) The defeat of Ahmadinejad's subsidy reforms, a proposal that would have raised the prices of subsidized goods - especially energy - and distributed cash payments to targeted segments of lower-income Iranians, received more media attention than the increased scrutiny of development projects. Some critics were concerned that a hasty implementation of the cash payments would have been a shock to Iran's economic system. A separate contact, a UAE-based Iranian economic consultant,

summarized the proposal for direct cash payments as a naked attempt to buy votes - especially in rural areas - because the payments would have started before the June election, while the energy prices hikes would not have occurred until after the election.

14. (S/NF) Our academic contact, however, was pleasantly surprised by the overall package of reforms, commenting "the program would make up for all his past mistakes in economic policy." The subsidy reforms were similar to policies the academic suggested seven years ago, and which the World Bank (one of his previous employers) and the International Monetary Fund have recommended to Iran for several years. Liberalizing energy prices would have been a large step in combating the waste, inefficiencies, and rent-seeking that plagues Iran's economy, and he described one anecdote of these distortions: On Iran's eastern border there are many people whose "job" is to fill up a car with a tank of subsidized Iranian gasoline and then drive it over the border to sell at a higher price.

15. (S/NF) A third setback for Ahmadinejad last month was the Majles' revival of Iran's Management and Planning Organization (MPO), whose main task is drawing up the annual budget and overseeing its implementation, according to our academic contact in Sharjah and a report in the Iranian press. Ahmadinejad dismantled the upper echelons of the MPO in 2006, a move widely criticized as consolidating power over the budget inside the President's office, but MPO offices in the provinces were maintained, according to an MPO employee from Khorasan-e Razavi who was in Dubai to apply for a visa. The MPO employee has continued to assemble the province's annual budget request to Tehran - presumably to the President's office - since 2006, and in her opinion the restoration of a national MPO to its pre-2006 form will depend heavily on who is elected President in June. A restored MPO is unlikely to have a significant impact on economic policy before the June election because the drafting of

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next year's budget will not begin until later this year, and its first opportunity to impact policy is probably the Fifth Development Plan, a five year plan that is currently being drafted, and which has historically been an MPO-produced document. A separate contact who is an economics professor in Yazd believes that restoration of the MPO is "the first thing that needs to be done" to improve Iran's economy, and notes that many former MPO officials were signatories to a series of open letters that criticized Ahmadinejad's economic policies.

16. (S/NF) Identifying the personalities or groups responsible for the defeats of the President's policies is difficult, and the fear of becoming targets of criticism will inhibit public claims of victory. Majles Speaker Ali Larijani's influence has certainly been enhanced, and he has the support of the Supreme Leader and conservative allies, although our academic contact in Sharjah is not a fan of his political or economic policies. The influence of scholars at Allameh Tabatabai University, who favor strict adherence to Iran's five- and twenty-year development plans and a restoration of the vital role of the MPO in the economy, provide the theoretical underpinning for many conservatives in the Majles, is also on the rise. Former Central Bank Governor Tahmasb Mazaheri is primarily responsible for recent declines in inflation and a downturn in the Iranian real estate market, according to the IRPO contact, and the continuation of Mazaheri's policies under the current Central Bank Governor, Mahmud Bahmani, is another sign that the President's room to maneuver on economic policy has been diminished. Mazaheri was fired when the head of Ahmadinejad's "Quick Return" loan program complained that the Central Bank was not funding that program, but most beneficiaries of these loans used their funds to speculate in real estate instead of

investing in the new businesses for which they were intended - a separate contact estimates 75% of these loans have failed.

17. (S/NF) Ahmadinejad's disregard for government-approved economic plans, especially Iran's Fourth Development Plan (currently in its fifth and final year), is key to understanding his recent sparring with the Larijani and the Majles over the budget, according to a Professor of Economics at Yazd University who is a supporter of former President Khatami and who has received a fellowship to teach at a U.S. university. The President's disregard for the Fourth Development Plan - which called for a gradual lifting of energy subsidies - is politically motivated because it bears the fingerprints of two of his rivals: former President Khatami's administration drafted the plan, and it was approved by Ali Akbar Hashemi Rafsanjani's Expediency Council, after the Guardians Council failed to ratify the plan. Other examples of Ahmadinejad's disregard for the law are his suspending - on his own authority - of the Majles-approved Value Added Tax (VAT) last fall, and his setting aside of the Fourth Development Plan's roadmap for the privatization of state-owned enterprises, according to the Yazd academic. Ahmadinejad's main problem is his egotism, in our contact's opinion, and he thought one of the last lines in Larijani's letter to the President defending the Majles' actions perfectly summarized the speaker's own feelings towards Ahmadinejad, "you should follow the law."

18. (S/NF) The hidden hand of the Islamic Revolutionary Guard Corps (IRGC) is another possible interpretation of Ahmadinejad's recent setbacks in the Majles, according to a separate contact who is UAE-based Iranian businessman in the paper industry. He believes the IRGC has been amassing political and economic power since the smashing of student protests in 1999, and a cardboard factory he invested \$4 million in was confiscated by the IRGC. Describing the direct cash payment plan and the promises of development projects in the provinces as Ahmadinejad's "vote collection plan," the businessman believes that the IRGC worked behind the scenes to thwart these programs and prevent Ahmadinejad from using public funds to increase his popularity in the run-up to the election. The IRGC has decided that it does not want Ahmadinejad to be the public face of Iran to the West for the next four years, but it has not yet decided on who it does want to support in the June election, the IRPO contact contended.

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19. (S/NF) Ahmadinejad will persevere in his efforts to distribute cash and economic benefits to lower-income Iranians despite the setbacks in the Majles because his priority in economic policy has always been social justice - even at the expense of economic development - according to a political counselor at the Japanese Embassy in Tehran who met with IRPO Officers on his way back to Tokyo. Since the budget defeat, Ahmadinejad has been noted in Iranian media as continuing to distribute free potatoes to crowds that gather for his speeches, and distributing approximately \$10 to employees of the Ministry of Foreign Affairs to attend a Nowruz speech. Confrontations over redistributive programs in a prospective second Ahmadinejad term would also continue because of the poor relationship between the President and Majles Speaker Larijani, according to several IRPO contacts. In terms of electoral politics, the Japanese diplomat warned that Iran's economic performance may not hurt Ahmadinejad with the many voters who distinguish their personal financial situation from the performance of the country's macroeconomic indicators.

110. (S/NF) Comment: The bruising that Ahmadinejad suffered last

month reveals the difficult political landscape Ahmadinejad faces in the weeks before the June election, and which he would face in a prospective second term. We are struck by the spectrum of factions that IRPO contacts report either authored Ahmadinejad's defeats or have welcomed them, from conservative allies of Larijani, to IRGC elements, to reformist academics. Even the supporters of one of Ahmadinejad's first initiatives - distributing "justice shares" of stock in privatized state companies to lower-income Iranians - realize that it is an evident failure. Now that most of his populist schemes, such as directing cash payments to lower-income Iranians, or distributing development projects during his tours to the provinces, have run into roadblocks, our academic contact in Sharjah assessed Ahmadinejad's accomplishments over the past four years by commenting "the emperor has no clothes." Having clipped Ahmadinejad's wings during the budget process, Larijani and other conservatives in the Majles may feel more empowered to confront the President on issues like government corruption.

11. (S/NF) Comment (Cont'd.): Iran's massive subsidy program will continue to distort Iran's economy and burden government finances as several of IRPO's contacts have observed, and the Supreme Leader's Nowruz message that criticized Iranians' extravagant and wasteful consumption of bread, water, and energy - all of which are subsidized - will keep the issue on the political agenda. We think the political landscape following Ahmadinejad's setbacks in March suggests that the IRIG will avoid any comprehensive action on subsidy reform and will take incremental steps, such as using media campaigns to encourage conservation or quietly cutting subsidies on discrete items like detergent powder (see Reftel), to address this issue. End comment.
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